ABSTRACT

A hedged exposure and an associated hedging instrument can be accounted for to reduce periodic earnings volatility associated with the hedged exposure. The accounting to reduce the earnings volatility includes designating a portion of the value of the financial exposure as being hedged by the hedging instrument. The designated portion is determined based on a price sensitivity of the hedging instrument with respect to changes in market value of an underlying instrument. In each of a number of sequential periods, the portion of the financial exposure is redesignated based on changed price sensitivity of the hedging instrument. Periodic earnings volatility associated with a hedged exposure also can be reduced by dividing (for accounting purposes) the hedging instrument into a first part (also referred to as a designated part) and a second part (also referred to as a residue part). This division is made in a way that ensures that changes in the value of the first part substantially offset changes in value of the financial exposure. The method also includes designating a portion of the first part as a hedge of the financial exposure such that the remainder of the first part offsets the delta of the second part. In each of a plurality of sequential periods, the portion of the first part is redesignated to maintain the relationship between the first part and the second part whereby the remainder of the first part offsets the delta of the second part.